

Select Committee on Pension Policy

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Executive Committee

September 16, 2003

3:30 - 5:30 PM

Senate Conference Rooms A-B-C, Olympia

AGENDA

(A) Possible Agenda Issues

- A-1 Relaxing Gain-sharing Safety Net Provisions
- A-2 Recovery of Lost Purchasing Power
- A-3 LEOFF 1 Survivor Benefits
- A-4 Extended School Year and Post-retirement Employment
- A-5 Plan 3 Vesting
- A-6 School District Payroll Reporting (As Paid/As Earned)
- A-7 Consequences of People Working Until 65
- A-8 Military Service Credit
- A-9 Issues Suggested to JCPP (from August meeting)
- A-10 Issues Suggested by Others (from August meeting)

(B) October Full Committee Agenda

(C) Future Agendas

Relaxing Gain-sharing Safety Net Provisions

Gain-sharing is the process of distributing extraordinary investment gains from retirement plan assets in the form of benefit increases – in PERS 1 and TRS 1 the benefit is an increase in the annual increase amount for retirees, and for plan 3 members the benefit is a lump-sum distribution to their member accounts.

The current threshold for defining extraordinary investment gains is average annual returns on the plan assets of over 10 percent for a four year period (the actuarially assumed rate of return on plan assets is 8 percent.) If that threshold is met, there will be distributions in the even-numbered years within those 4-year periods of the amount of return over 10 percent. There were gain-sharing distributions in 1998 and 2000. Returns on plan assets have been negative in 2001 and 2002.

This proposal seeks to lower the 10 percent threshold for defining extraordinary investment gains to 8 percent.

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	3/6/03	HB 1507

SUMMARY OF BILL:

This bill impacts the Public Employees' Retirement System Plan 1 (PERS 1), Public Employees' Retirement System Plan 2/3 (PERS 2/3), Teachers' Retirement System Plan 1 (TRS 1), Teachers' Retirement System Plan 2/3 (TRS 2/3), and School Employees Retirement System Plan 2/3 (SERS 2/3) by changing the definition of "extraordinary investment gains."

Under this bill, an extraordinary investment gain would occur when the average rate of return on assets over the previous 4-year period exceeds 8%. When this gain occurs, one-half of the gain is distributed to eligible members. The distribution of extraordinary investment gains is known as gain-sharing.

Effective Date: 90 days after session.

CURRENT SITUATION:

Currently, gain-sharing in PERS 1, PERS 3, TRS 1, TRS 3, and SERS 3 occurs on even-numbered years. An extraordinary investment gain occurs when the average rate of return on assets for the previous 4-year period exceeds 10%. When this gain occurs, one-half of the gain for PERS 1 and TRS 1 is used to fund a permanent increase in the PERS 1 and TRS 1 Uniform COLA for current and future retirees. One-half of the gain for PERS 2/3, TRS 2/3 and SERS 2/3 is deposited in the defined contribution accounts of Plan 3 members. The allocation of the Plan 3 extraordinary investment gain to a member's defined contribution account is based on the member's service credit in relation to the service credit of all Plan 2/3 members.

All experience gains (or losses), excluding any extraordinary investment return used every other year for gain sharing, are used to reduce (or increase) contribution rates.

MEMBERS IMPACTED:

All active and inactive members in PERS, SERS and TRS Plans 1 and Plans 3 are affected by this bill. As of September 30, 2001 the number of members were: 80,829 in PERS 1, 48,156 in TRS 1, 46,126 in TRS 3, and 24,999 in SERS 3. There were also 128,955 active members in PERS 2 who were eligible to transfer to Plan 3.

The first possible gain-sharing benefit under this bill for PERS 1 and TRS 1 would occur on January 1, 2004. Due to recent asset losses, the extraordinary investment gain is likely to be zero on this date. The bill may also provide a retroactive gain-sharing payment as of January 1, 2002 for the Plans 3.

ASSUMPTIONS:

Amounts paid out in future gain-sharing benefits will not be available to offset future losses that occur when investment return is less than the assumed rate of 8%. The easiest way to capture this additional cost is to lower the assumed rate of investment return. We used simulated rates of return from the Washington State Investment Board for the current asset allocation to determine the appropriate reduction in the effective rate of investment return for the gain-sharing benefits provided under this bill. This adjustment varies by plan as follows:

Plan 1

The effect of distributing 100% of Plan 1 extraordinary investments gains, under the current 10% threshold, is to reduce the effective rate of investment return by 2%. This decreases the current investment return assumption of 8% to 6%. For Plan 1, currently one-half of this gain is distributed every other year (every 2 years). This results in a net rate of return assumption of 7.5% (or $8\% - 50\% \text{ times } 2\% / 2$).

The effect of distributing 100% of Plan 1 extraordinary investments gains, under the new 8% threshold is to reduce the effective rate of investment return by 2.5%. This decreases the current investment return assumption of 8% to 5.5%. For Plan 1, one-half of this gain is distributed every other year (every 2 years). This results in a net rate of return assumption of 7.37% (or $8\% - 50\% \text{ times } 2.5\% / 2$).

Plan 2/3

The adjustment to the rate of return assumption is a bit more complicated in the Plans 2/3. First of all, the entire Plan 2/3 extraordinary investment gain must be allocated to the Plans 3 in total. Secondly, once allocated to the Plans 3, the entire Plan 3 extraordinary investment gain must then be allocated to PERS 3, TRS 3 and SERS 3.

Allocation to Plan 3

Assuming 12% of PERS 2 members transfer to PERS 3, Plan 3 member service credit is about 35% of all Plan 2/3 member service credit. In other words, under these assumptions, 35% of any extraordinary investment gain in Plan 2/3 would be allocated to the Plans 3 in total.

The effect of distributing 100% of Plan 2/3 extraordinary investments gains, under the current 10% threshold, is to reduce the effective rate of investment return by 2%. This decreases the current investment return assumption of 8% to 6%. Currently, one-half of the extraordinary investment gain in Plan 2/3, attributable to Plan 3, is distributed every other year (every 2 years). This results in a 0.18% reduction in the 8% assumed rate of return assumption since $35\% \text{ of the total Plan 2/3 gain is allocated to the Plans 3 (or } 35\% \text{ times } 50\% \text{ times } 2\% \text{ reduction} / 2)$.

Under the proposed 8% threshold the reduction in the interest rate is 0.22% (35% of 0.63%).

Allocation to Plan 3 Systems

While the overall impact is a 35% distribution of the entire Plan 2/3 extraordinary investment gain, the effect on PERS, TRS, and SERS is quite different. For example, if an average gain of 0.5% (half of 2% paid every other year) or 0.63% (half of 2.5% paid every other year) were to occur on the valuation date, they would result in the following distributions as a percent of each System's assets:

Gain	PERS	TRS	SERS	TOTAL
0.50%	0.05%	0.40%	0.51%	0.50% x 35%=0.18%
0.63%	0.06%	0.50%	0.63%	0.63% x 35%=0.22%

The amount of gain per service credit is the same for each eligible Plan 3 member. The average pay and the amount of assets, however, is markedly different in each system. For example, the average salary of an active SERS 3 member is roughly 50% of their TRS 3 counterparts. The market value of SERS 2/3 assets is about 40% of TRS 2/3 assets and 13% of PERS 2 assets. As a result, any Plan 3 extraordinary investment gain will be a larger proportion of SERS assets relative to PERS and TRS assets.

Currently, the number of retirees in Plan 3 is relatively small and the initial allocation of any gain-sharing benefit among the Systems is unpredictable. In the long term, however, we would expect the distribution to be similar to that shown above.

As a result, the net return on assets for the Plans 2/3 would be adjusted as follows:

	<u>PERS 2/3</u>	<u>TRS 2/3</u>	<u>SERS 2/3</u>	<u>TOTAL</u>
Interest Rate	8.00%	8.00%	8.00%	8.00%
Current Gain-Sharing	0.05%	0.40%	0.51%	0.18%
Additional Gain-Sharing	0.01%	0.10%	0.12%	0.04%
Net Interest Rate	7.94%	7.50%	7.37%	7.78%

FISCAL IMPACT:

Actuarial Determinations:

The bill will impact the actuarial funding of these systems by increasing the present value of benefits payable under these Systems and the required actuarial contribution rate as shown below:

<i>(Dollars in Millions)</i>	System:	Current	Increase	Total
Actuarial Present Value of Projected Benefits	PERS 1	\$12,244	\$944	\$13,188
	PERS 2/3	12,428	211	12,639
(The Value of the Total Commitment to all Current Members)	TRS 1	10,050	806	10,856
	TRS 2/3	4,024	692	4,716
	SERS 2/3	1,610	302	1,912
Unfunded Actuarial Accrued Liability	PERS	\$860	\$829	\$1,689
(The Portion of the Plan 1 Liability that is Amortized at 2024)	TRS	400	709	1,109
Unfunded Liability (PBO)	PERS 1	\$301	\$825	\$1,126
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	PERS 2/3	(4,874)	82	(4,792)
	TRS 1	(22)	717	695
	TRS 2/3	(1,750)	239	(1,511)
	SERS 2/3	(724)	113	(612)
Required (Employer) Contribution Rate	PERS	2.05%	0.91%	2.96%
	TRS	2.22%	3.22%	5.44%
	SERS 2/3	1.74%	3.51%	5.25%

Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures is projected to be:

Effective September 1, 2003	PERS	TRS	SERS
Increase in Contribution Rates:			
Employee	0.00%	0.00%	0.00%
Employer State	0.91%	3.22%	3.51%
Costs (in Millions):			
2003-2005			
State:			
General Fund	\$ 25.7	\$ 176.9	\$ 40.5
Non-General Fund	<u>40.9</u>	<u>0.0</u>	<u>0.0</u>
Total State	\$ 66.6	\$ 176.9	\$ 40.5
Local Government	\$ 59.1	\$ 36.3	\$ 35.8
2005-2007			
State:			
General Fund	\$ 31.2	\$ 217.4	\$ 53.1
Non-General Fund	<u>49.7</u>	<u>0.0</u>	<u>0.0</u>
Total State	\$ 80.9	\$ 217.4	\$ 53.1
Local Government	\$ 71.7	\$ 44.6	\$ 47.0
2003-2028			
State:			
General Fund	\$ 593.1	\$4,389.3	\$1,239.3
Non-General Fund	<u>970.1</u>	<u>0.0</u>	<u>0.0</u>
Total State	\$1,563.2	\$4,389.3	\$1,239.3
Local Government	\$1,386.2	\$ 899.1	\$1,099.0

State Actuary's Comments:

Gain-sharing benefits provided under current law are not pre-funded. Existing gain-sharing benefits represent a material liability to the affected Systems. This liability should be recognized under the funding method of the affected Systems (or pre-funded). The contribution rate increases above reflect the cost of pre-funding both the existing gain-sharing and the additional gain-sharing benefit provided under this bill.

The methodology of how to pre-fund gain-sharing benefits is currently under review. The methodology is subject to change pending any guidance we receive from the American Academy of Actuaries.

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2001 actuarial valuation report of the Public Employees' Retirement System, Teachers' Retirement System, and School Employees Retirement System.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

The net interest rate used to value the gain-sharing benefit was 8.0% - 0.5% for the current gain-sharing and 7.50% - 0.13% = 7.37% for the additional gain-sharing. As described above this rate was pro-rated for Plan 2/3 because only a pro-rata amount of the gain-sharing will be distributed to Plan 3.

Without doing a projection of the service credits for the current employees, it is difficult to determine if this percentage might change overtime and by how much. However, the ratio of the Present Value of Projected Benefits of Plan 3 members to Plan 2 members indicates that this service credit will be about 35%. In TRS and SERS, new employees will enter Plan 3. If half of the PERS members enter Plan 2, and the other half enter Plan 3, the overall percentage will change to 71%, over the very long run. The impact of new employees is not recognized in the current rates until they enter the plan and is not considered in this fiscal note.

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
5. This fiscal note is intended for use only during the 2003 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Unfunded Actuarial Accrued Liability (UAAL): The cost of Plan 1 is divided into two pieces:

- The Normal Cost portion is paid over the working lifetime of the Plan 1 active members. The remaining cost is called the UAAL.
- The UAAL is paid for by employers as a percent of the salaries of all Plan 1, 2 and 3 members until the year 2024.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Recovery of Lost Purchasing Power

Over time, plan 1 retirees (TRS and PERS) experience a gradual and persistent diminishment of their retirement benefit's purchasing power. Even after age 66 when they are eligible for the Uniform COLA, the loss of purchasing power continues. The Uniform COLA represents the equivalent of a 1 percent COLA for the great majority of PERS 1 and TRS 1 retirees. If consumer prices rise at a seemingly modest 3 percent per year, PERS 1 and TRS 1 retirees continue to lose ground.

This proposal seeks to provide for a "catch-up" COLA and a lower age eligibility for the PERS 1 and TRS 1 Uniform COLA.

LEOFF 1 Survivor Benefits

In the 2002 session, ESB 6380 (C 158 L 02) amended the LEOFF chapter to provide for an actuarially reduced survivor benefit for a spouse from a post-retirement marriage. Formerly, members were not allowed to designate spouses from post-retirement marriages as beneficiaries. LEOFF members would prefer that this survivor option not be actuarially reduced.

RCW 41.24.164 Optional reduced retirement allowance—Continues for spouse otherwise ineligible for survivor

benefits. (1) No later than July 1, 2003, the department shall adopt rules to allow a member who meets the criteria set forth in subsection (2) of this section to choose an actuarially equivalent benefit that pays the member a reduced retirement allowance and upon death, such portion of the member's reduced retirement allowance as the department by rule designates shall be continued throughout the life of a spouse ineligible for survivor benefits under RCW 41.26.160 or 41.26.161.

(2) To choose an actuarially equivalent benefit according to subsection (1) of this section, a member shall:

(a) Have the retirement allowance payable to the retiree not subject to periodic payments pursuant to a property division obligation as provided for in RCW 41.50.670;

(b) Have no qualified ex spouse under RCW 41.26.162(1); and

(c) Choose an actuarially reduced benefit during a one-year period beginning one year after the date of marriage to the survivor benefit-ineligible spouse.

(3) A member who married a spouse ineligible for survivor benefits under RCW 41.26.160 or 41.26.161 prior to the effective date of the rules adopted under this section and satisfies the conditions of subsection (2)(a) and (b) of this section has one year to designate their spouse as a survivor beneficiary following the adoption of the rules.

(4) No benefit provided to a child survivor beneficiary under RCW 41.26.160 or 41.26.161 is affected or reduced by the member's selection of the actuarially reduced spousal survivor benefit provided by this section.

(5)(a) Any member who chose to receive a reduced retirement allowance under subsection (1) of this section is entitled to receive a retirement allowance adjusted in accordance with (b) of this subsection if:

(i) The retiree's survivor spouse designated in subsection (1) of this section predeceases the retiree; and

(ii) The retiree provides to the department proper proof of the designated beneficiary's death.

(b) The retirement allowance payable to the retiree from the beginning of the month following the date of the beneficiary's death shall be increased by the following:

(i) One hundred percent multiplied by the result of (b)(ii) of this subsection converted to a percent;

(ii) Subtract one from the reciprocal of the appropriate joint and survivor option factor.

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	3/12/03	HB 1715

SUMMARY OF BILL:

This bill impacts the Law Enforcement Officers' and Fire Fighters' Retirement System Plan 1 (LEOFF 1) by providing survivor benefits to spouses of post-retirement marriages. To be eligible, spouses must have been married to the LEOFF 1 member for at least 5 years prior to the member's death and the survivor benefit is deferred to age 55.

Effective Date: 90 days after session.

CURRENT SITUATION:

Currently, the surviving spouse of a LEOFF 1 retiree is eligible to receive a survivor benefit which is equal to the retiree's monthly retirement allowance. The survivor benefit includes a yearly cost-of-living-adjustment for the full amount of any increase in the Seattle-Tacoma-Bremerton Consumer Price Index for Wage Earners and Clerical Workers (CPI-W).

Ex-spouses and spouses from post-retirement marriages cannot qualify as a surviving spouse in LEOFF 1. A spouse must have been married to a LEOFF 1 member for one year prior to retirement, or separation from service, in order to qualify as a surviving spouse.

MEMBERS IMPACTED:

Any of the 1,315 active, 29 terminated vested, or 7,894 retired members of this system who might marry or re-marry after their separation from service could be affected by this bill.

The eligible spouse of a retired member receives the same benefit as the retired member. The eligible spouse of a deferred vested member receives the same benefit as the member would have received at age 50.

The average retirement benefit is currently \$ 2,620 a month.

ASSUMPTIONS:

Currently, 60% of members die with an eligible spouse. For purposes of this bill, we have assumed an additional 20% (or half of the remainder) would die with an eligible spouse due to the expanded eligibility for survivor benefits under this bill.

FISCAL IMPACT:

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

Law Enforcement Officers' and Fire Fighters' Retirement System			
<i>(Dollars in Millions)</i>	Current	Increase	Total
Actuarial Present Value of Projected Benefits (The Value of the Total Commitment to all Current Members)	\$ 4,244	\$ 234	\$ 4,478
Unfunded Actuarial Accrued Liability (The Portion of the Plan 1 Liability that is Amortized at 2024)	\$ (1,125)	\$ 234	\$ 891
Unfunded Liability (PBO) (The Value of the Total Commitment to all Current Members Attributable to Past Service)	\$ (1,209)	\$ 230	\$ (979)
Required Contribution Rate (state)	(7.24)%	1.36%	(5.88)%

State Actuary's Comments:

There is no immediate fiscal impact on the System while the plan remains fully funded. The required contribution rate is below 0% before and after this proposed changed.

A recent survey of 10% of the retired member and beneficiary population of fire fighters from LEOFF 1 indicated that 11% have married since retirement.

Extended School Year Post-Retirement Employment Issue

A TRS 1 retiree returning to work in a district that uses an extended school year schedule might have their benefit suspended if they subsequently work for a school district that uses a regular school year schedule.

Fiscal Year / School Year 1											Fiscal Year / School Year 2												
J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J
		Extended School Year											Regular School Year										

Hours Analysis Based on 10 Working Days in July and a 183 day Contract

Hours per school day	Hours per school year	Hours worked in July	Hours in Year 2
8.0	1,464	80	1,544
7.5	1,372.5	75	1,447.5
7.0	1,281	70	1,351

This proposal seeks to redress this potential problem by changing the statutory definition of school year. This would also result in a common definition of school year by both TRS 1 and TRS 2/3.

HOUSE BILL REPORT

SHB 1298

As Passed House:

March 11, 2003

Title: An act relating to vesting after five years of service in the defined benefit portion of the public employees' retirement system, the school employees' retirement system, and the teachers' retirement system plan 3.

Brief Description: Vesting after five years of service in the defined benefit portion of the public employees' retirement system, the school employees' retirement system, and the teachers' retirement system plan 3.

Sponsors: By House Committee on Appropriations (originally sponsored by Representatives Sommers, Alexander, Fromhold, Conway and Benson).

Brief History:

Committee Activity:

Appropriations: 2/11/03, 2/13/03 [DPS].

Floor Activity:

Passed House: 3/11/03, 93-0.

Brief Summary of Substitute Bill

- Reduces the required length of service for vesting in the Public Employees' Retirement System, the School Employees' Retirement System, and the Teachers' Retirement System Plans 3 from 10 years to five years.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 26 members: Representatives Sommers, Chair; Fromhold, Vice Chair; Sehlin, Ranking Minority Member; Pearson, Assistant Ranking Minority Member; Alexander, Buck, Clements, Cody, Conway, Cox, DeBolt, Dunshee, Grant, Hunter, Kagi, Kenney, Kessler, Linville, McDonald, McIntire, Miloscia, Pflug, Ruderman, Schual-Berke, Sump and Talcott.

Staff: David Pringle (786-7310).

Background:

A member of a pension plan, including the plans of the Washington state retirement systems, must complete specific amounts of qualified employment before he or she is entitled to a pension benefit. This period of service requirement is called "vesting."

In the Public Employees' Retirement System (PERS) Plans 1 and 2, the School Employees' Retirement System (SERS) Plan 2, and the Teachers' Retirement System (TRS) Plans 1 and 2, the vesting period for employees is five years. After five years of service in a plan 1 or plan 2, members' defined benefits are based in part upon the number of qualified years of service they have worked multiplied by 2 percent of their final average salaries. The method of calculating final average salary varies by plan.

In the PERS 3, the SERS 3, and the TRS 3, the vesting period for employees is 10 years, or five years including one year after age 54. After 10 years of service, a Plan 3 member's defined benefit is based upon the number of qualified years of service he or she has worked multiplied by 1 percent of final average salary. Members who were already vested in Plan 2 when they transferred to the PERS 3, the SERS 3, or the TRS 3 remain vested members.

Summary of Substitute Bill:

Beginning May 1, 2003 the vesting period for the PERS 3, the SERS 3, and the TRS 3 is reduced to five years of qualified service at any age.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect on May 1, 2003.

Testimony For: Ten years is too long a vesting period, and this change is a matter of fairness to bring the Plans 3 in line with the vesting periods in Plans 1 and 2. For the protection of retirees, this change is a good idea, and it brings us parallel to the vesting periods in private pension plans. Though many members are already vested by prior service transferred from Plan 2, we support this change going forward.

Testimony Against: None.

Testified: Gene Forrester, Washington Senior Citizens Lobby; David Westberg, Stationary Engineers AFL-CIO; Randy Parr, Washington Education Association; and Lynn Maier, Washington Public Employees Association.

FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:

CODE:

DATE:

BILL NUMBER:

Office of the State Actuary

035

2/20/03

SHB 1298

SUMMARY OF BILL:

This bill impacts the Teachers Retirement System (TRS), School Employee's Retirement System (SERS), and Public Employee's Retirement System (PERS) Plans 3 by lowering the vesting period for the defined benefit portion of these plans from ten years to five.

Effective Date: May 1, 2003.

CURRENT SITUATION:

New Plan 3 members of TRS, SERS, and PERS are vested in the defined benefit portion of their Plan after ten years of service, or after five years of service if 12 months of that service is earned after attaining age 54. Plan 3 members are immediately vested in the defined contribution side of their Plan. Those who transferred from Plan 2 to Plan 3 were automatically vested if they had five years of service in Plan 2 as of July 1, 1996, September 1, 2000 and June 1, 2003, the initial transfer dates for TRS, SERS and PERS respectively.

The transfer period for existing PERS Plan 2 members to transfer from PERS Plan 2 to PERS Plan 3 is provided in two separate windows:

- State agency and higher education employees were given a 6-month window that ended September 1, 2002. 12% of eligible employees elected to transfer from PERS Plan 2 to PERS Plan 3.
- Employees of local government and other organizations are given a 9-month window that ends on June 1, 2003.

MEMBERS IMPACTED:

Since the initial transfer date was about five, one and zero years prior to the most recent valuation date for TRS, SERS and PERS respectively, those with less than ten, six and five years may potentially be affected by this bill.

Members who had five years of service before the initial transfer period, or who have five years of service with one year of service earned after age 54 or who have ten years of service are already vested and not affected by this bill.

TRS: There are 28,820 (27,713 under age 55) active members with less than ten years of service who might be affected by this bill out of the 44,193 total TRS 3 members of this system.

SERS: There are 11,475 (10,689 under age 55) active members with less than six years of service who might be affected by this bill out of the 24,284 total SERS 3 members of this system.

PERS: There are 50,159 (46,354 under age 55) active members with less than five years of service out of the 128,955 total PERS Plan 2 members who might be affected by this bill if they opt to transfer to PERS Plan 3.

FISCAL IMPACT:

Actuarial Determinations:

The impact of the bill is insufficient to affect PERS contribution rates. This is based on the assumption that 12% of the total PERS Plan 2 membership will eventually transfer to PERS Plan 3 (the total from both transfer windows). The **estimated** sensitivity of the change in contribution rates to the transfer assumption is displayed below:

Transfer percent to PERS Plan 3	Increase in Required Contribution Rate
16%	0.01%
41%	0.02%
59%	0.03%
74%	0.04%
86%	0.05%
95%	0.06%

The bill will impact the actuarial funding of the TRS and SERS system by increasing the present value of benefits payable under the System (for existing members impacted by this bill) and the required actuarial contribution rate as shown below:

<i>(Dollars in Millions)</i>		Current	Increase	Total
Actuarial Present Value of Projected Benefits				
(The Value of the Total Commitment to all Current Members)				
	TRS	\$ 4,024	\$ 10	\$ 4,034
	SERS	\$ 1,610	\$ 5	\$ 1,615
Unfunded Actuarial Accrued Liability				
(The Portion of the Plan 1 Liability that is Amortized at 2024)				
		NA	NA	NA
Unfunded Liability (PBO)				
(The Value of the Total Commitment to all Current Members Attributable to Past Service)				
	TRS	\$ (1,750)	\$ 5	\$ (1,745)
	SERS	\$ (724)	\$ 2	\$ (722)
Required Contribution Rate (Employer)				
	TRS	2.22%	0.03%	2.25%
	SERS	1.74%	0.04%	1.78%

(The TRS rate of 2.22% is composed of the employer normal cost rate of 1.50% and a UAAL rate or "Plan 2/3 Employer for Plan 1" rate of 0.72%. This bill would increase the normal cost rate from 1.50% to 1.53%, the UAAL rate would remain unchanged)

(The SERS rate of 1.74% is composed of the employer normal cost rate of 1.10% and a UAAL rate or "Plan 2/3 Employer for Plan 1" rate of 0.64%. This bill would increase the normal cost rate from 1.10% to 1.14%, the UAAL rate would remain unchanged)

Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures (for existing members impacted by this bill) is projected to be:

Effective September 1, 2003	<u>TRS</u>	<u>SERS</u>
Increase in Contribution Rates:		
Employee	0.03%	0.04%
Employer State	0.03%	0.04%
Costs (in Millions):		
2003-2005		
State:		
General Fund	\$ 1.8	\$ 0.5
Non-General Fund	<u>0.0</u>	<u>0.0</u>
Total State	\$ 1.8	\$ 0.5
Local Government	\$ 0.4	\$ 0.5
2005-2007		
State:		
General Fund	\$ 2.0	\$ 0.6
Non-General Fund	<u>0.0</u>	<u>0.0</u>
Total State	\$ 2.0	\$ 0.6
Local Government	\$ 0.4	\$ 0.5
2003-2028		
State:		
General Fund	\$45.5	\$ 14.9
Non-General Fund	<u>0.0</u>	<u>0.0</u>
Total State	\$45.5	\$ 14.9
Local Government	\$ 9.3	\$ 13.2

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2001 actuarial valuation report of the Teachers Retirement System, School Employee's Retirement System, and Public Employee's Retirement System.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

The number of transfers as of September 30, 2002 to PERS 3 divided by the number of state and higher education employees was used to estimate the percentage of employees who would transfer to Plan 3 during the initial transfer period.

$$(8,667 / 70,045 = 12\%)$$

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
5. This fiscal note is intended for use only during the 2003 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Unfunded Actuarial Accrued Liability (UAAL): The cost of Plan 1 is divided into two pieces:

- The Normal Cost portion is paid over the working lifetime of the Plan 1 active members. The remaining cost is called the UAAL.
- The UAAL is paid for by employers as a percent of the salaries of all plan 1, 2 and 3 members until the year 2024.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by Plan assets.

SUBSTITUTE HOUSE BILL 1298

State of Washington

58th Legislature

2003 Regular Session

By House Committee on Appropriations (originally sponsored by Representatives Sommers, Alexander, Fromhold, Conway and Benson)

READ FIRST TIME 02/17/03.

1 AN ACT Relating to vesting after five years of service in the
2 defined benefit portion of the public employees' retirement system, the
3 school employees' retirement system, and the teachers' retirement
4 system plan 3; amending RCW 41.32.875, 41.35.680, and 41.40.820;
5 providing an effective date; and declaring an emergency.

6 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

7 **Sec. 1.** RCW 41.32.875 and 2000 c 247 s 903 are each amended to
8 read as follows:

9 (1) NORMAL RETIREMENT. Any member who is at least age sixty-five
10 and who has((÷

11 ~~(a))~~ completed ((ten)) five service credit years((÷~~or~~

12 ~~(b) Completed five service credit years, including twelve service~~
13 ~~credit months after attaining age fifty four; or~~

14 ~~(c))~~ or completed five service credit years by July 1, 1996, under
15 plan 2 and who transferred to plan 3 under RCW 41.32.817((÷))
16 shall be eligible to retire and to receive a retirement allowance
17 computed according to the provisions of RCW 41.32.840.

18 (2) EARLY RETIREMENT. Any member who has attained at least age
19 fifty-five and has completed at least ten years of service shall be

1 eligible to retire and to receive a retirement allowance computed
2 according to the provisions of RCW 41.32.840, except that a member
3 retiring pursuant to this subsection shall have the retirement
4 allowance actuarially reduced to reflect the difference in the number
5 of years between age at retirement and the attainment of age sixty-
6 five.

7 (3) ALTERNATE EARLY RETIREMENT. Any member who has completed at
8 least thirty service credit years and has attained age fifty-five shall
9 be eligible to retire and to receive a retirement allowance computed
10 according to the provisions of RCW 41.32.840, except that a member
11 retiring pursuant to this subsection shall have the retirement
12 allowance reduced by three percent per year to reflect the difference
13 in the number of years between age at retirement and the attainment of
14 age sixty-five.

15 **Sec. 2.** RCW 41.35.680 and 2000 c 247 s 906 are each amended to
16 read as follows:

17 (1) NORMAL RETIREMENT. Any member who is at least age sixty-five
18 and who has((÷

19 ~~(a)) completed ((ten)) five service credit years((÷or~~
20 ~~(b) Completed five service credit years, including twelve service~~
21 ~~credit months after attaining age fifty-four; or~~

22 ~~(c)) or completed five service credit years by September 1, 2000,~~
23 under the public employees' retirement system plan 2 and who
24 transferred to plan 3 under RCW 41.35.510((÷))
25 shall be eligible to retire and to receive a retirement allowance
26 computed according to the provisions of RCW 41.35.620.

27 (2) EARLY RETIREMENT. Any member who has attained at least age
28 fifty-five and has completed at least ten years of service shall be
29 eligible to retire and to receive a retirement allowance computed
30 according to the provisions of RCW 41.35.620, except that a member
31 retiring pursuant to this subsection shall have the retirement
32 allowance actuarially reduced to reflect the difference in the number
33 of years between age at retirement and the attainment of age sixty-
34 five.

35 (3) ALTERNATE EARLY RETIREMENT. Any member who has completed at
36 least thirty service credit years and has attained age fifty-five shall
37 be eligible to retire and to receive a retirement allowance computed

1 according to the provisions of RCW 41.35.620, except that a member
2 retiring pursuant to this subsection shall have the retirement
3 allowance reduced by three percent per year to reflect the difference
4 in the number of years between age at retirement and the attainment of
5 age sixty-five.

6 **Sec. 3.** RCW 41.40.820 and 2000 c 247 s 309 are each amended to
7 read as follows:

8 (1) NORMAL RETIREMENT. Any member who is at least age sixty-five
9 and who has((÷

10 ~~(a))~~ completed ((ten)) five service credit years((÷or

11 ~~(b) Completed five service credit years, including twelve service~~
12 ~~credit months after attaining age fifty-four; or~~

13 ~~(c))~~ or completed five service credit years by the transfer
14 payment date specified in RCW 41.40.795, under the public employees'
15 retirement system plan 2 and who transferred to plan 3 under RCW
16 41.40.795((÷))

17 shall be eligible to retire and to receive a retirement allowance
18 computed according to the provisions of RCW 41.40.790.

19 (2) EARLY RETIREMENT. Any member who has attained at least age
20 fifty-five and has completed at least ten years of service shall be
21 eligible to retire and to receive a retirement allowance computed
22 according to the provisions of RCW 41.40.790, except that a member
23 retiring pursuant to this subsection shall have the retirement
24 allowance actuarially reduced to reflect the difference in the number
25 of years between age at retirement and the attainment of age sixty-
26 five.

27 (3) ALTERNATE EARLY RETIREMENT. Any member who has completed at
28 least thirty service credit years and has attained age fifty-five shall
29 be eligible to retire and to receive a retirement allowance computed
30 according to the provisions of RCW 41.40.790, except that a member
31 retiring pursuant to this subsection shall have the retirement
32 allowance reduced by three percent per year to reflect the difference
33 in the number of years between age at retirement and the attainment of
34 age sixty-five.

35 NEW SECTION. **Sec. 4.** This act is necessary for the immediate

1 preservation of the public peace, health, or safety, or support of the
2 state government and its existing public institutions, and takes effect
3 May 1, 2003.

--- END ---

School District Payroll Reporting (As Paid / As Earned)

Currently, some 280 school districts use an accounting and payroll system established by the Washington School Information Processing Cooperative (WSIPC). Attempts to use other off-the-shelf accounting and payroll systems have had little success. It has been proposed by TRS representatives that by allowing retirement contributions to be reported to DRS “as paid” instead of under the proposed reported “as earned”, school districts could use alternative payroll systems and thus save the State money. Payroll would be reported “as earned” for the calculation of the average final compensation at the time of retirement.

Consequences of People Working Until 65

The eligibility requirement to receive normal or unreduced retirement in PERS, SERS, and TRS 2 is 5 years of service and attainment of age 65; in the plans 3, it is 10 years of service and attainment of age 65. A member may receive an actuarially reduced early retirement after 20 years of service and attainment of age 55. A member with 30 years of service and age 55 may receive a benefit reduced 3% per year from age 65.

The Washington Association of School Administrators and the Association of Washington School Principals propose lowering the service eligibility for the 3% early retirement adjustment factor to 25 years.

Military Service Credit

All Systems and Plans award up to 5 years of service credit for interruptive military service.

PERS 1 also awards service credit for up to 5 years of prior military service if that service were during specific periods of conflict.

WSPRS 1 also awards service credit for up to 5 years of prior military service regardless of the period of service.

In the recent creation of WSPRS 2, service credit for prior military service was eliminated.

Issues Suggested to JCPP

1. **Retire-Rehire Report:**

No later than July 1, 2003, the Office of the State Actuary is statutorily required by, C 010, L01, E2 to prepare a report for the JCPP regarding the fiscal and policy impact of C 010, L01, E2. The JCPP is required to report to the legislative fiscal committees no later than October 1, 2003 on the program impacts of the act.

2. **Public Safety Retirement Benefits:**

Public Safety Benefits are in reference to increased/earlier retirement benefits for those PERS 2/3 members in high-risk, or high stress jobs (jailers, corrections officers, PUD line workers, etc.)

3. **Part-time Educational Service Associates:**

Educational Service Associates (ESAs) are TRS members who are counselors, psychologists, social workers, speech language pathologist/audiologists, occupational therapists, physical therapists, and nurses. At this time, only counselors may annualize their salaries for retirement benefit purposes if they are employed less than full time.

4. **Survivor Benefits:**

LEOFF 1 members are allowed to designate a beneficiary from a post-retirement marriage and accept an actuarially-reduced benefit. LEOFF 1 representatives would prefer that the benefit not be actuarially reduced.

5. **Extended School Year and Post-Retirement Employment:**

Under existing post-retirement employment provisions, some TRS 1 rehires from extended school year districts may be subject to having their benefit suspended even when they work 1,500 hours per school year or less.

6. **School District Payroll:**

Currently, some 280 school districts use an accounting and payroll system established by the Washington School Information Processing Cooperative (WSIPC). Attempts to use other off-the-shelf accounting and payroll systems have had little success. It has been proposed by TRS representatives that by allowing retirement contributions to be paid to DRS "as paid" instead of paid "as earned," school districts could use alternative payroll systems and thus save the state money.

7. **Projected Rates and Funding:**

Presentation of the most recent actuarial valuation and projected rates.

SELECT COMMITTEE ON PENSION POLICY

Proposed Meeting Schedule

(September 17, 2003)

August 19, 2003

9 AM - 12:30 PM, Senate Hearing Room 4

Election of Officers

Role of SCPP:

Review of Ch 295

Open Public Meetings Act

Ethics Law

Rules of Procedure

Session Update

Possible Interim Issues

Meeting Schedule

November

9 AM - 12:30 PM

September 16, 2003

1 - 3:30 PM, Senate Hearing Room 4

Election of Chair and Vice Chair

Rules of Procedure

Post-retirement Employment Report

PERS Public Safety

Part Time Educational Staff Associates

Meeting Schedule

December

9 AM - 12:30 PM

Proposed Legislation

October

9 AM - 12:30 PM

PERS Public Safety Committee Report

Post-retirement Employment Report

Projected Rates and Funding

School District Payroll Reporting